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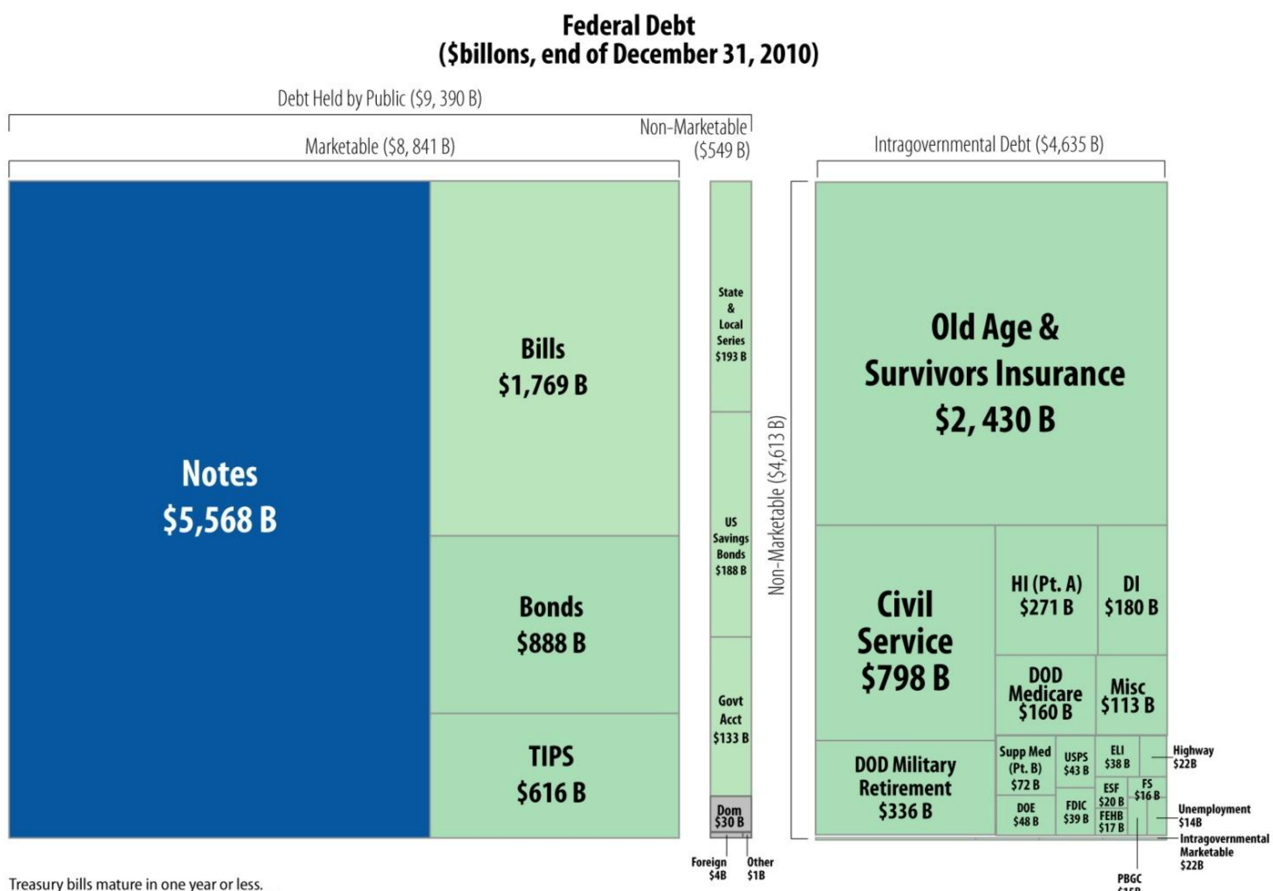
RSC Policy Brief: The National Debt and the Debt Limit

May 12, 2011

The rapidly expanding national debt continues to put a strain on America's families, businesses, and future. The current debate on raising the debt limit has placed the fiscal situation in stark relief and provides an opportunity for conservatives to advance serious spending reforms. This policy brief is intended to provide background on the nature of the national debt and the history, mechanics, and impact of the debt limit.



Treasury bills mature in one year or less.
Treasury notes have maturities of one to 10 years.
Treasury bonds have maturities over 10 years.
TIPS are Treasury Inflation-Protected Securities.

Chart Provided by CRS

Source: U.S. Treasury. Details available at http://www.treasurydirect.gov/govt/reports/pd/mspd/2010/opdx122010.xls. **Note:** See text.

Various National Debt Statistics

- Over the past 5 years (April 28th, 2006 – April 29th, 2011), the debt held by the public has more than doubled, from $4.819 trillion to $9.654 trillion, an increase of $4.835 trillion or an increase of 15% per year.
- Under President Obama, the debt limit has increased three times, with a total increase of $2.979 trillion. Since 2007, it has increased six times, with a total increase of $5.329 trillion.
- The debt held by the public is expected to increase by $7.823 trillion over the next decade.
- The debt held by the public is projected to be 69% of GDP this year and 77% of GDP by 2021.
- The net interest paid on the debt is projected to be $225 billion this year and $792 billion in 2021.
- As of December 31, 2010, the national debt per American was $45,426.
- As of Feb. 28th, 2011, China held 12% of the debt held by the public. Foreign entities held 47% of the debt held by the public.

Sources: Congressional Budget Office, Treasury Department, Census Bureau

The National Debt

The national debt is the sum of the Debt Held by the Public and Intragovernmental Holdings. Debt Held by the Public is the federal debt held by individuals, corporations, banks, state and local governments, foreign governments, and any other non-federal government entity. Intragovernmental Holdings are the federal debt held by federal government trust funds, such as Social Security and Medicare. In other words, the public debt measures what the federal government owes to outside creditors. The national debt is made up of the public debt plus what the government owes to itself. As of May 4, 2011, the Debt Held by the Public was $9.698 trillion, Intragovernmental Holdings amounted to $4.635 trillion, and the total national debt was $14.334 trillion.

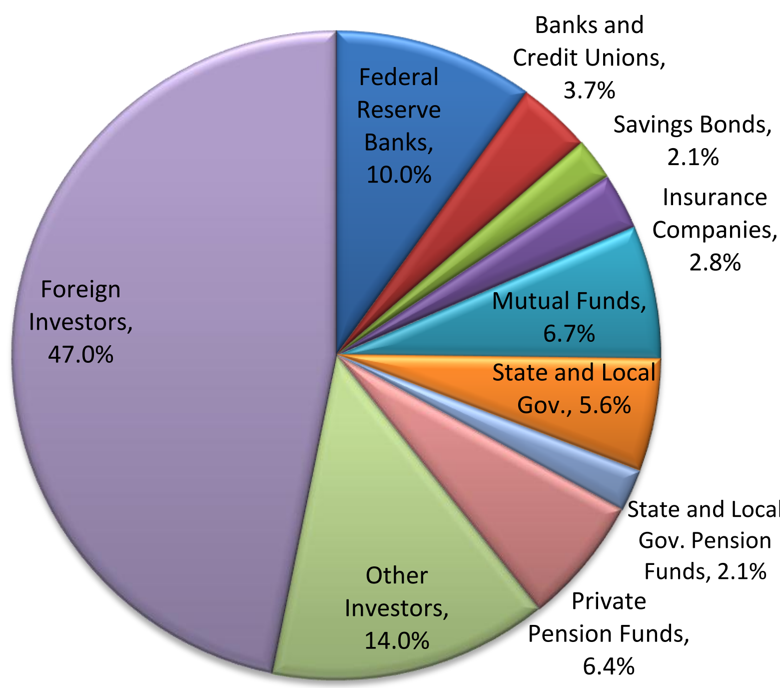
Debt Held by the Public (public debt) is held in several different forms. Treasury bills are short-term securities that mature in one year or less, and as of December 2010 constitute 19% of the public debt. Treasury notes are longer-term securities which mature between 2 and 10 years from the date issued, and constitute 59% of the public debt. Treasury bonds are long-term securities which mature after a term exceeding 10 years from the date issued, and constitute 9.5% of the public debt. Treasury Inflation-Protected Securities (TIPS) are a unique form of security that protects against inflation and matures after 5, 10, or 20 years; TIPS constitute 6.5% of the public debt. The final form of public debt is nonmarketable debt, which is composed of primarily state and local government debt and savings bonds, and constitutes 6% of the public debt.

Intragovernmental Holdings are debt held by government trust funds. When trust funds such as Social Security or Medicare receive revenues in excess of the benefit payments paid out, the excess funds are invested in special federal debt securities. These special securities can be redeemed at any time when funds are needed by the trust fund and the Treasury pays interest on the securities on a semi-annual basis.

The national debt is administered by the Office of Debt Management in the Treasury Department. Once the Office determines that additional funds need to be borrowed to meet federal obligations, it instructs the Bureau of Public Debt to auction off debt securities. Because of the constant need for additional funds, and to roll-over existing debt, debt securities are auctioned off on a regular schedule. The amount of each security and the interest rate offered on them changes, however, depending on the needs of the Treasury and the public's demand for the securities. During a period of low interest rates, such as is the case currently, the Treasury Department will finance new debt primarily with a shorter maturity in order to take advantage of those low rates. However, as that debt matures faster, the Treasury Department is forced to refinance the debt more frequently which can lead to more volatile and uncertain interest payments in the future. Currently, the average maturity of Debt Held by the Public is at its lowest level since 1984, off a peak in 2000.

The Debt Held by the Public is currently held by a wide variety of entities and investors:

Holders of U.S. Public Debt (Percentage of Total Holdings)

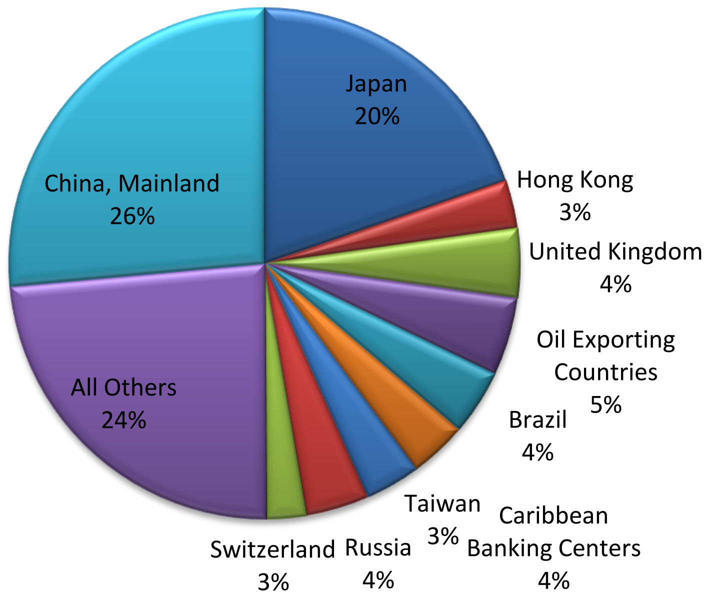


Source: [Treasury Department – September 2010]

Other Investors includes individuals, corporations, government-sponsored enterprises, brokers, etc.)

As of September 2010, the largest foreign holder of Treasury securities was China with $1.15 trillion in holdings, followed by Japan with $861 billion. All other nations held less than $225 billion individually, but held $2.31 trillion collectively.

Foreign Holders of U.S. Debt (Percentage of Total Foreign Holdings)



Oil Exporting Countries include Ecuador, Venezuela, Indonesia, Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates, Algeria, Gabon, Libya, and Nigeria.

Caribbean Banking Centers include Bahamas, Bermuda, Cayman Islands, Netherlands Antilles and Panama, and the British Virgin Islands.

Source: Treasury Department – September 2010

The Debt Limit

As a restraint on the level of federal borrowing and as a requirement for fiscal accountability, Congress sets a statutory debt limit, which is a cap on the total value of outstanding debt securities Treasury is permitted to issue. The debt limit applies to approximately 99.5% of federal debt with exemptions for only extremely limited interest expenses, Federal Financing Bank debt, and Guaranteed Debt. The total outstanding federal debt on May 4, 2011 was $14.33 trillion and the total outstanding debt subject to the limit was $14.28 trillion, a difference of a mere $52 billion. The current debt limit, as established in February 2010, is $14.29 trillion. Because of sustained severe deficit spending, the debt limit is currently expected by the Treasury Department to be reached on May 16, 2011. If the debt limit is reached, the Treasury Department is prohibited from offering additional debt for auction that would cause it to exceed the limit and must make any payments from other revenue streams. However, the Treasury

Department is able to exercise options for several weeks to prevent any impact on its ability to meet its day-to-day obligations.

As the total amount of debt nears the debt limit, the Treasury Department has several "extraordinary actions" available to postpone reaching the debt limit. These actions include suspending the sale of nonmarketable debt (savings bonds, debt sold to state and local government), delaying public debt auctions, withdrawing funds held at the Federal Reserve, and exchanging Treasury securities for securities held by the Federal Financing Bank in order to utilize its exemption from the debt limit. The Treasury Secretary is also authorized to declare a "debt issuance suspension period," which helps it avoid reaching the debt limit by permitting the suspension of investments in and redemption of securities held by the Civil Service Retirement and Disability Trust Fund and Federal Thrift Savings Plan. There is precedent for the Treasury Department to exercise "extraordinary actions," as it has done so in five past years: 1985, 1995, 1996, 2002, and 2003. After the 1985 crisis, Congress established procedures to ensure that payments diverted from government trust funds as an "extraordinary action" are repaid in full once the debt limit is raised. The Treasury Department announced on May 2, 2011 that it had begun "extraordinary actions" to prevent reaching the debt limit, but that it expected to exhaust all options to so by August 2, 2011.

Since its creation in 1917, the debt limit has never been fully reached. Therefore, the consequences of reaching the limit are very difficult to predict with real confidence. If the limit is reached, Treasury will no longer be able to fulfill all obligations as they come due and will be forced to determine which obligations to meet what revenues it collects. Current estimates by CRS project that the federal government will incur obligations of $738 billion over revenues received over the remainder of fiscal year 2011.

However, the Treasury Department will receive more than sufficient revenue during the remainder of fiscal year 2011, $1.114 trillion between April and September 2011, to continue making payments on the debt with only roughly $105 billion in interest costs projected over the same period. In spite of that, the Treasury Department announced recently that prioritization of debt payments is "unworkable" and would represent a "failure by the U.S. to stand behind its commitments." In light of that announcement, it appears that the Treasury Department is claiming that if the debt limit is fully reached it will not make any effort to prioritize federal debt payments and would default on the federal government's debt obligations. Historically, during a similar period in 1985, the Treasury Department maintained that it lacked the authority to establish priorities on which obligations to pay because it believed all obligations presented to it have equal standing in law, which would require it to fulfill obligations in the order they were received. At that time, however, GAO issued a preliminary finding that there is no requirement that the Treasury Department treat all obligations equally and concluded that the Treasury Department has the authority to prioritize payments. In spite of that inconsistency, it appears that, without new statutory guidance such as the Full Faith and Credit Act (see next page), the Treasury Department is claiming that it is unwilling to prioritize debt payments to avoid default.

The impact of a default caused by the Treasury Department's failure to make debt payments would be widespread. Interest payments would most likely not be paid on some federal debt, and some debt securities would not be redeemed. Federal employees' pay and payments to government contractors and vendors would be delayed, in some cases incurring additional interest expenses for the government. Without access to a reliable funding stream, the activities of federal departments and agencies would be disrupted. The Social Security Agency may not be able to pay any benefits if sufficient funds to pay 100% of scheduled benefits are not available. The U.S. would most likely lose its AAA sovereign debt credit rating, impacting the interest rates demanded by investors in American debt and increasing the cost of future debt service. The U.S. dollar could lose value relative to other currencies, threatening its status as the reserve currency and increasing the cost of imported goods. Economic growth and employment could be negatively affected from the loss of investor confidence and government payments.

Congress has raised the debt limit many times since the establishment of the limit. Since World War II, the debt limit has been raised 81 times, and in the 5 years since Democrats retook control of Congress in 2007 alone, the debt limit has been increased 6 times by a total of $4.479 trillion. According to analysis shared by House leadership, since 1985, Congress has passed a clean debt limit increase only 10 times out of 27 increases. According to the same analysis, over the past 26 years, 8 increases of the debt limit have been passed with parallel budget reforms.

The RSC is promoting a "cut, cap, and balance" strategy to precede any possible debt ceiling increase. This three part solution would call for discretionary and mandatory spending reductions that would cut the deficit in half next year, statutory and enforceable total-spending caps to reduce federal spending to 18% of GDP, and sending to the States a Balanced Budget Amendment with strong protections against federal tax increases and including a Spending Limitation Amendment.

Also, in order to prevent default from a failure to make debt payments, RSC members Rep. Tom McClintock, Rep. Virginia Foxx, Rep. Scott Garrett, and RSC Chairman Jim Jordan, along with Sen. Pat Toomey, are sponsoring H.R. 421 and S. 163, the Full Faith and Credit Act, which would require the Treasury Secretary, after reaching the debt limit, to use incoming revenues to pay principal and interest due on debt held by the public before making any other payments.

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